IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. INTELLIQUIS INTERNATIONAL, INC., MARK W. TIPPETS, DAVID A. JONES, AND KEVIN E. ORTON, Defendants.	)	Case No. 2:02-CV-674 PGC MEMORANDUM & ORDER District Judge Paul G. Cassell Magistrate Judge David Nuffer

I. PROCEDURAL BACKGROUND

On March 14, 2003, Plaintiff Securities and Exchange Commission (SEC) filed a motion for summary judgment against Defendants Intelliquis International, Inc., Mark W. Tippets, and Kevin E. Orton. (Dkt. no. 31.) Under the local rules, Defendants had thirty days after service of the motion, or until approximately April 14, 2003, to file an opposition. DUCivR 56-1(b). To date, Defendants Intelliquis and Orton have not filed an opposition to the motion.

On April 24, 2003, well after the thirty days had expired without any response from Defendants, the SEC submitted a Proposed Order Granting Motion for Summary Judgment and Judgment of Permanent Injunction and Other Relief. On April 30, 2003, in apparent response to the SEC's proposed order, Defendant Tippets submitted a document entitled Motion to Deny the

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SEC Motion for Summary Judgment and Judgment of Permanent Injunction and Other Relief. This document was apparently intended as a proposed order because it contains a signature line for the district judge, but is not signed by Defendant Tippets. Because this document was unsigned, it was not filed by the Clerk of the Court, and presently is lodged in the file.[1]

Insofar as Defendant Tippets intended this document as an opposition to the SEC's motion for summary judgment, the submission is insufficient to defeat the motion. First, the document was submitted after the time for filing an opposition had expired. The court may ignore an untimely filed opposition to a motion for summary judgment. DUCivR 56-1(f).

Second, the document is unsigned. Rule 11 of the Federal Rules of Civil Procedure provides that in the case of a person not represented by an attorney, all papers must be signed by the party, and that unsigned papers shall be stricken. Fed. R. Civ. P. 11(a). Since the document at issue was unsigned, it cannot be considered in opposition to summary judgment.

Third, the local rules provide that all material facts set forth in the statement of the movant "will be deemed admitted for the purpose of summary judgment, unless specifically controverted by the statement of the opposing party identifying material facts of record which the meet the requirements of Fed. R. Civ. P. 56." DUCivR 56-1(c). Although Defendant Tippets has attempted to controvert some of the SEC's facts, he has failed to support his assertions with

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[1]The SEC filed a motion to strike Defendant Tippets' Motion to Deny the SEC Motion for Summary Judgment. (Dkt. # 37.) Because Defendant Tippets' motion was never filed, the SEC's motion is moot.

affidavits or other evidence in the record as required by Rule 56 of the Federal Rules of Civil Procedure. See Diaz v. Paul J. Kennedy Law Firm, 289 F.3d 671, 674-75 (10th Cir. 2002); United States v. Simons, 129 F.3d 1386, 1388-89 (10th Cir. 1997); Pasternak v. Lear Petroleum Exploration, Inc., 790 F.2d 828, 834 (10th Cir. 1986). Thus, the material facts submitted by the SEC are deemed admitted for the purpose of summary judgment pursuant to DUCivR56-1(c). Nevertheless, the court will address, in footnotes to the undisputed facts, some of the purported factual disputes raised by Defendant Tippets' document.

II. FACTS

The following facts, taken from the SEC's memorandum in support of its motion for summary judgment, are deemed admitted pursuant to DUCivR 56-1(c):

1. Intelliquis is a Nevada corporation headquartered in Draper, Utah. Intelliquis is a republisher, marketer, and supporter of utility, productivity, and communication software products for the retail market. (Form 10-KSB, ex. 1.)[2]

2. On February 5, 1999, Intelliquis stock began trading on the Over-the Counter Bulletin Board. (Ex. 1 at 5.)

[2]Unless otherwise indicated, all exhibits are attached to the SEC's memorandum in support of its motion for summary judgment, docket no. 32.

3. Defendant Tippets served as the Vice President of Marketing and Sales for Intelliquis from its inception. Tippets was also a director of Intelliquis. (Ex. 1 at 9; Tippets Test., ex. 2 at 51.)

4. Defendant David A. Jones is a licensed Certified Public Accountant ("CPA") and served as Intelliquis' CFO from November 1998 until October 2000. (Jones Test., ex. 3 at 13, 26-27.)

5. Defendant Orton was a CPA until June 20, 2002 when he voluntarily surrendered his CPA license. Intelliquis engaged Orton to audit Intelliquis' financial statements for the years ended December 31, 1998 and December 31, 1999. Those financial statements were included in the Forms 10- KSB filed with the Commission for the fiscal years ended December 31, 1998 and December 31, 1999. (Tippets Test., ex. 2 at 16; Form 10-KSB, ex. 1; Form 10-KSB, ex. 4.)

6. Defendant Orton was convicted of securities fraud, wire fraud, and racketeering in an unrelated matter, and is currently incarcerated at a federal correctional facility in Safford, Arizona. As a result of the criminal conviction, the SEC entered an order denying Defendant Orton the privilege of appearing or practicing before the Commission. (Order, ex. 5.)

The Intelliquis Business Model

7. Intelliquis generated revenue by selling its software products to distributors. Its software products were principally marketed through Ingram Micro, Inc. ("Ingram"), the largest software distributor in the United States. (See ex. 1 at 3.)

8. Intelliquis' transactions with Ingram accounted for approximately 70% of all Intelliquis' sales. (Tippets Test., ex. 2 at 79; Jones Test., ex. 3 at 103.)

9. Intelliquis' products included Intellifix 2000, a Y2K program that could be used by a consumer to fix any software or hardware bugs that arose as a result of the year 2000. That product had a limited shelf life and became obsolete when the anticipated Y2K problems never materialized. (Yaw Test., ex. 6 at 28-29; Tippets Test., ex. 2 at 138; Jones Test., ex. 3 at 126.)

Intelliquis' Relationship with Ingram

10. Intelliquis' relationship with Ingram was embodied in two agreements, a Start-up Agreement that went into effect on January 15, 1998 and a Distribution Agreement, effective December 20, 1999. (Exs. 7 & 8, respectively.) Tippets negotiated those agreements and executed them on behalf of Intelliquis. (See exs. 7 & 8.)

11. Both agreements gave Ingram an unconditional right to return any Intelliquis product for full credit. (Ex. 7 at 2; ex. 8 at 6.) Defendants Tippets and Jones were aware that Ingram had the right to return any Intelliquis product at any time. (Tippets Test., ex. 2 at 86; Jones Test., ex. 3 at 116.)

12. Essentially, Ingram sold Intelliquis' products on a consignment basis. That meant Intelliquis would not get paid by Ingram until its products were purchased by an end user. (Tippets Test., ex. 2 at 77; Jones Test., ex. 3 at 116.)

13. In fact, Intelliquis retained title to its products until Ingram sold the products to an end user. (Tippets Test., ex. 2 at 84; Jones Test., ex. 3 at 60, 114.)[3]

14. Intelliquis was on what Ingram termed "Buyers Review." That meant before Ingram paid anything to Intelliquis, Ingram adjusted the balance due to account for any Intelliquis product that Ingram had on hand, any Intelliquis product in the distribution channel, and any debits resulting from advertising or other promotional schemes. As a result, Ingram did not pay Intelliquis for its software until Ingram's customer, such as Staples or Office Max, sold the software to an end user. (Caramanica Test., ex. 9 at 16.)[4]

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[3] Defendant Tippets disputes that the sales were consignment sales. Although he admits that the start-up agreement contained a clause indicating that Intelliquis retained title to its products until Ingram sold the products to its customers, he asserts that the 1999 agreement superseded the start-up agreement and changed the payment terms to 60 days. (Tippets' Motion to Deny the SEC Motion for Summary Judg. ¶ 9)(hereinafter "Tippets' Mot.") Despite Mr. Tippets' assertions to the contrary, the 1999 agreement clearly gives Ingram the unconditional right to return any product for full credit. (Dist. Agree., ex. 8 at 6.) Moreover, Defendant Tippets testified in his deposition that the agreement with Ingram was a consignment agreement, and that Intelliquis retained title to the product and would not be paid until the product was sold to the end user. (Tippets Test., ex. 2 at 77, 84.)

[4] Defendant Tippets states that all companies that signed agreements with Ingram were on "Buyers Review." (Tippets' Mot. ¶ 10.) Even if true, however, this statement is irrelevant since agreements that Ingram might have had with other companies, whatever their nature, have no bearing on this case. Defendant Tippets also states that "Buyers Review" simply meant that the

15. Jones and Tippets were aware of the formula used by Ingram to calculate the amount owed to Intelliquis because Ingram representatives discussed the formula with them repeatedly. (Caramanica Test., ex. 9 at 20; Carpenter Test., ex. 10 at 14-16.)

16. Throughout its relationship with Intelliquis, Ingram disputed the amount Intelliquis claimed that Ingram owed to Intelliquis. Tippets constantly badgered Ingram to send increased payment to Intelliquis. (Caramanica Test., ex. 9 at 72; Tippets Test., ex. 2 at 91, 150-54; Jones Test., ex. 3 at 75, 125).

17. Ingram repeatedly explained to Tippets the formula used by Ingram to calculate whether it owed Intelliquis any money. (Carpenter Test., ex. 10 at 14-16; Caramanica Test., ex. 9 at 20; Jones Test., ex. 3 at 120-21.)

Intelliquis' Accounting for Revenue from Sales to Ingram

18. Intelliquis booked revenue and recorded an account receivable at the time it shipped its software products to Ingram. (Jones Test., ex. 3 at 124; Yaw Test., ex. 6 at 70-71.)

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buyer must approve distribution of funds before payments could be made. (Id.) Nevertheless, it is clear that before Ingram paid anything to Intelliquis, adjustments were made to the balance due as described above. (Caramanica Test., ex. 9 at 16.)

19. Intelliquis did not account for the adjustments and deductions Ingram would make to the accounts receivable balance before remitting payment to Intelliquis. (See Form 10-KSB, ex. 1; Jones Test., ex. 3 at 119-26.)[5]

20. Due to Intelliquis' practice of booking revenue at the time its products were shipped to Ingram and not properly accounting for the adjustments, Intelliquis' accounts receivable balance grew exponentially. (Jones Test., ex. 3 at 119; Yaw Test., ex. 6 at 84, 88-89.)

Generally Accepted Accounting Principles for the Recognition of Revenue

21. A fundamental responsibility of management is to ensure that the company's financial statements are prepared in accordance with Generally Accepted Accounting Principles ("GAAP"). (Westergard Rpt., ex. 11 at 2-6.)

22. GAAP provides that "revenues should ordinarily be accounted for at the time a transaction is completed, with appropriate provision for uncollectible accounts." (Westergard Rpt., ex. 11 ¶ 21.)

23. When the right to return exists, as with Intelliquis' sales to Ingram, GAAP dictates that

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[5]Defendant Tippets disputes this fact, stating that "Intelliquis at all times allowed for a reserve account according to recognized and accepted accounting practices." (Tippets' Mot. ¶ 12.) This is a bare, unsworn statement with no support in the record, and is thus insufficient to raise an issue of material fact. Further, admissible evidence in the record supports the fact that Intelliquis did not account for the adjustments and deductions made by Ingram as discussed above. (See Form 10-KSB, ex. 1; Jones Test., ex. 3 at 119-26.)

revenue from the sales transaction shall be recognized at the time of the sale only if all of the following conditions are met:

a. The seller's price to the buyer is substantially fixed or determinable at the date of sale.

b. The buyer has paid the seller, or the buyer is obligated to pay the seller and the obligation is not contingent on resale of the product.

c. The buyer's obligation to the seller would not be changed in the event of theft or physical destruction or damage of the product.

d. The buyer acquiring the product for resale has economic substance apart from that provided by the seller.

e. The seller does not have significant obligations for future performance to directly bring about resale of the product by the buyer.

f. The amount of future returns can be reasonably estimated.

(Westergard Rpt. ¶ 23, ex. 11)(quoting FASB[6] No. 48, paragraph 6).

24. In addition, Statement of Position 97-2 ("SOP 97-2"), "Software Revenue Recognition," provides specific guidance on when revenue should be recognized, and in what amounts, by companies involved in licensing, selling, leasing, or otherwise marketing computer software. (Westergard Rpt., ex. 11 ¶ 24.)

25. SOP 97-2 provides as follows: "If the arrangement does not require significant production, modification, or customization of software, revenue should be recognized when all of the following criteria are met.

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[6]"FASB" is an abbreviation for Financial Accounting Standards Board.

- Persuasive evidence of an arrangement exists.
- Delivery has occurred.
- The vendor's fee is fixed or determinable.
- Collectibility is probable." (Westergard Rpt., ex. 11 ¶ 26).

Intelliquis' Recognition of Revenue Did Not Conform to GAAP

26. Intelliquis' accounting for revenue associated with sales to Ingram was not recorded in accordance with Generally Accepted Accounting Principles because the sales did not meet all of the criteria of FASB No. 48, paragraph 6. (Westergard Rpt., ex. 11 ¶¶ 49-50.)

27. First, Intelliquis' price to Ingram was not fixed or determinable at the date of sale. The price paid to Intelliquis by Ingram was subject to certain adjustments based on the amount of Intelliquis inventory Ingram had on hand, the amount of inventory in the distribution channel, and the amount of any pass-through promotions. (Caramanica Test., ex. 9 at 16; Tippets Test., ex. 2 at 85, 90, 142; Jones Test., ex. 3 at 125; Westergard Rpt., ex. 11 ¶ 49.)

28. Second, Ingram's payment to Intelliquis was contingent on the resale of Intelliquis software to end-user consumers. (Tippets Test., ex. 2 at 85; Jones Test., ex. 3 at 125; Westergard Rpt., ex. 11 ¶ 49.)

29. Finally, the amount of future returns could not be reasonably estimated due to the nature of Intelliquis' software product, Intellifix 2000, a Y2K product. Intellifix 2000 sales depended on consumers experiencing software and hardware difficulties resulting from the

switch to calendar year 2000. Those computer glitches never materialized, rendering Intellifix 2000 worthless. (Tippets Test., ex. 2 at 138; Yaw Test., ex. 6 at 28-29; Jones Test., ex. 3 at 126.)

30. Moreover, Intelliquis' sales to Ingram did not meet the requirements of SOP 97-2. (Westergard Rpt., ex. 11 ¶ 49.) First, Intelliquis' fee was not fixed or determinable because Ingram had Intelliquis on buyers review. (Caramanica Test., ex. 9 at 16) As a result, the amount due to Intelliquis was subject to numerous adjustments and charges which were not determinable until after a final sale to an end user. (Caramanica Test., ex. 9 at 16; Carpenter Test., ex. 10 at 14-16.)

31. In addition, collectibility was not probable as required by SOP 97-2. The accounts receivable balance due to Intelliquis from Ingram grew exponentially over the course of their relationship. (Yaw Test., ex. 6 at 84; Jones Test., ex. 3 at 119; Westergard Rpt., ex. 11 ¶ 44.) In fact, about one third of the $3,000,000 Intelliquis claimed that Ingram owed it was more than 120 days overdue. (Westergard Rpt., ex. 11 ¶ 37.) Moreover, when asked by Intelliquis' independent auditor to confirm the amount it owed to Intelliquis, Ingram disclosed a discrepancy of over $3,000,000. (Westergard Rpt., ex. 11 ¶ 37.)[7]

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[7]Defendant Tippets disputes that Intelliquis did not meet the requirements of FASB No. 48 paragraph 6 and SOP 97-2 . (Tippets' Mot. ¶¶ 13-14.) Again, this is an unsworn, unsupported statement which is insufficient to create a genuine issue of material fact. Moreover, Mr. Tippets' assertion is directly refuted by the expert report of Ray O. Westergard which states that the requirements of FASB 48, paragraph 6, and SOP 97-2 were not met. (Westergard Rpt., ex. 11 ¶ 49.) Defendant Tippets has also submitted Forms 10-K from four companies which, according to Defendant Tippets, show that Intelliquis followed the same accounting practices as other publicly held companies. However, as the SEC points out, the accounting practices of

Intelliquis' Financial Statements

32. As detailed above, Intelliquis improperly recorded revenue upon shipping software to Ingram, contrary to GAAP. (Westergard Rpt., ex. 11 ¶¶ 49-50.)

33. The improper booking of revenue from sales to Ingram resulted in Intelliquis' materially overstating revenue in its financial statements for the years ended December 31, 1998 and December 31, 1999. (Westergard Rpt., ex. 11 ¶ 50.)[8]

34. Intelliquis' accounts receivable from sales to Ingram accounted for 72% and 77% of Intelliquis' total accounts receivable at December 31, 1999, and December 31, 1998, respectively. (Westergard Rpt., ex. 11 ¶ 47.)

35. Accounts receivable represented 66% and 70% of Intelliquis' total assets on December 31, 1999, and December 31, 1998, respectively. (Westergard Rpt., ex. 11 ¶ 48.)

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other companies are irrelevant to the issues in this case. Further, the Forms 10-K submitted by Defendant Tippets do not contain any information regarding the companies' revenue recognition practices.

[8]Defendant Tippets disputes this statement, adding that he had no knowledge or participation concerning Intelliquis' accounting practices. As repeatedly discussed, Defendant Tippets' unsworn statements are not admissible to oppose a motion for summary judgment. Further, although his alleged lack of knowledge might bear on his culpability, it has no bearing on the accuracy of the statement that Intelliquis' improper recognition of revenue resulted in overstated revenue in its financial statements. In addition, as the SEC points out, Defendant Tippets' statements concerning accounting practices are inconsistent in that he claims to have no knowledge of accounting principles, but at other times quotes accounting literature and uses accounting principles to support his claims.

36. Based on the audit of Intelliquis' financial statements for the year ended December 31, 1999, Intelliquis' auditor concluded that any errors in excess of $48,184 would be material to Intelliquis' financial statements. (Materiality worksheet, ex. 18.)

37. Ultimately, Intelliquis was not entitled to collect over $1.5 million Intelliquis booked as revenue from Ingram. That amount was material to Intelliquis' financial statements. (Materiality worksheet, ex. 18.)

38. Thus, the failure to adhere to GAAP resulted in a material error in the financial statements of Intelliquis. (Westergard Rpt., ex. 11 ¶ 49.)

39. The materially misstated financial statements were included in the Forms 10-KSB filed with the Commission for the fiscal years ended December 31, 1998 and 1999. (Westergard Rpt. ex. 11 ¶ 50.)

Defendant Tippets' Knowledge

40. Tippets knew that Intelliquis' contracts with Ingram guaranteed Ingram an unlimited right to return Intelliquis' products. (Tippets Test., ex. 2 at 98; Jones Test., ex. 3 at 60-61.)

41. Tippets knew that Intelliquis sold its software through Ingram on a consignment basis and that Intelliquis would not receive payment from Ingram until its products sold through their dealers to an end user. (Tippets Test, ex. 2 at 77, 94-95, 98; Jones Test., ex. 3 at 58, 63-64, 125.)

42. Tippets knew that Ingram consistently disputed the amounts Intelliquis claimed that Ingram owed and that Ingram's account receivable was not fully collectible. (Tippets Test., ex. 2 at 150-54; Jones Test., ex. 3 at 120-21; Parry Decl., ex. 20 ¶¶ 6-7.) Tippets was aware of this fact because he had numerous meetings and discussions with Ingram during which Ingram fully explained its disagreement with Intelliquis regarding the amount it owed. (Caramanica Test., ex. 9 at 20; Carpenter Test., ex. 10 at 14-16.)

43. In addition, Defendant Jones explained to Tippets that Intelliquis was improperly recording revenue from its transactions with Ingram. (Parry Decl., ex. 20 ¶¶ 6-7.)

44. In fact, when Ingram refused to confirm its account receivable balance when requested by Intelliquis' auditors, Defendant Jones brought that discrepancy to Tippets' attention. However, Tippets made no effort to reconcile the discrepancy. (See Jones Test., ex. 3 at 91-92.)

45. Further, Tippets ignored a warning from former Board of Directors member, Douglas Cole. When Cole resigned from Intelliquis' board, he wrote to Intelliquis to inform the company that it improperly accounted for revenue. (Letter to Bernard Yaw, dated January 21, 2000, ex. 12.) Tippets failed to investigate Mr. Cole's claim that Intelliquis had overstated revenue. (Tippets Test., ex. 2 at 122-23.)[9]

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[9]Tippets now states that he asked Cole to resign, and asserts that Cole and others were involved in an elaborate scheme involving Intelliquis stock. (Tippets' Mot. ¶ 17.) As with all of Defendant Tippets' statements in opposition to summary judgment, this is an unsworn and unsupported allegation that is insufficient to create a genuine issue of material fact.

Defendant Orton's Involvement

46. Defendant Orton was Intelliquis' independent auditor. He was retained to audit Intelliquis' financial statements for the years ending December 31, 1998 and December 31, 1999. (Tippets Test., ex. 2 at 16; Redding Test., ex. 13 at 12, 41-42.)

47. Orton was retained to audit Intelliquis' financial statements in accordance with Generally Accepted Auditing Standards ("GAAS"). (Engagement Letter, ex. 14.) Although the engagement letter is on Crouch Bierwolf letterhead, Intelliquis understood that Orton would perform the audit work for Intelliquis. (Redding Test., ex. 13 at 47.)[10]

48. GAAS requires that an audit be performed by qualified individuals with the requisite level of knowledge and experience, and that the auditor exercise due professional care in performing the audit. In addition, GAAS requires that the auditor obtain sufficient, competent evidence to afford a reasonable basis for his opinion regarding the financial statements under audit. (Westergard Rpt., ex. 11 ¶ 57.)

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[10]Defendant Tippets disputes this statement, stating that the accounting firm of Crouch Bierwolf was retained to conduct the audit, and that the accounting firm signed all financial filings with the SEC. Again, Defendant Tippets' unsworn statement is insufficient to create an issue of material fact. Although the relationship between Defendant Orton and Crouch Bierwolf is unclear, Defendant Tippets admitted in his deposition that Defendant Orton performed the audit. (Tippets Test., ex. 2 at 16.) This was confirmed by the testimony of David Redding who was hired by Defendant Orton to do the fieldwork for the audit. (Redding Test., ex. 13 at 41-42, 47.)

49. Orton hired David Redding, a non-CPA, to assist him in the Intelliquis audit fieldwork. (Redding Test., ex. 13 at 28, 41-42.) Redding had a B.S. in accounting, but had not performed an audit in more than twenty years and had not attended continuing education classes in the past twenty-five years. Consequently, Mr. Redding was not qualified to perform the audit work assigned to him by Defendant Orton. (Id. at 28-29, 72; Westergard Rpt., ex. 11 ¶ 57.)

50. Redding received little or no guidance from Defendant Orton during the Intelliquis audit fieldwork. (See Redding Test., ex. 13 at 124-25; Westergard Rpt., ex. 11 ¶ 57.)

51. During the audit fieldwork, Redding sent a letter to Ingram asking Ingram to confirm its account payable balance for amounts Intelliquis claimed it was owed. The letter stated that according to Intelliquis' records, Ingram owed it $3,267,186.79. The letter requested that Ingram confirm the amount by signing the letter and returning it. (Letter to Ingram Accounts Payable, dated March 22, 2000, ex. 15.)

52. On April 13, 2000, Ingram responded by faxing the confirmation letter back to Redding. Ingram indicated that according to its records, it only owed Intelliquis a balance of $7,236. (Fax to Redding, dated April 13, 2000, ex. 16.)

53. Redding and Orton made no effort whatsoever to reconcile the difference between the amount payable on Ingram's books and the amount Intelliquis claimed it was owed. (Redding Test., ex. 13 at 153.) Similarly, they did not make any effort to determine why Intelliquis accounts receivable showed that more than $1,000,000 of the amount owed by Ingram was more than 120 days overdue. (See ex. 15.) Both Redding and Orton ignored these red flags

and allowed the uncollectible accounts receivable to remain on Intelliquis' books. (See Redding Test., ex. 13 at 153.) They did not make any adjustments to Intelliquis' accounts receivable based on the information received from Ingram. (See Forms 10-KSB, exs. 1 & 4.)

54. Orton and Redding also ignored other red flags. As discussed above, on January 21, 2000, Douglas Cole, a member of Intelliquis' Board of Directors resigned. In his resignation letter, he indicated that two of the reasons for his resignation were "[a]ccounting practices within the corporation," and "[r]ecognition of revenue contrary to industry norms." (Ex. 12.) Redding reviewed a copy of this letter during the course of the Intelliquis audit, but chose to ignore it as sour grapes by a disgruntled board member. (Redding Test., ex. 13 at 125.)

55. Tippets also ignored Cole's letter and complaints regarding the company's method of revenue recognition. (Tippets Test., ex. 2 at 123.)

56. Orton never instructed Redding to perform any additional test work to determine the validity of Intelliquis' claim that the amounts it claimed Ingram owed were in fact collectible. (See Redding Test.. ex. 13, at 153.)

57. In fact, Orton was on vacation in Hawaii at the time the audit work was finalized and Intelliquis' financial statements were filed. (See id. at 164.)

58. In the opinion of Ray O. Westergard, a CPA and expert for the SEC, there were substantial deficiencies in the professional services performed by Defendant Orton in the audit of Intelliquis' consolidated financial statements for the year ended December 31, 1999. Defendant Orton did not comply with GAAS, and the financial statements were not presented in accordance

with GAAP. Further, Defendant Orton's opinion on the financial statements was not supported by the audit work that was done. As a result, Defendant Orton assisted Intelliquis in filing materially false and misleading financial statements for the year ended December 31, 1999. (Westergard Rpt., ex. 11 ¶ 59.)

Defendant Tippets' Sales of Intelliquis Stock

59. Between February 23, 2000 through March 14, 2001, Defendant Tippets sold 527,250 shares of Intelliquis stock. Tippets realized $188,807.99 from those sales. (Tippets Test., ex. 2 at 63-64; Korb Decl., ex. 17 ¶ 5.)

60. Defendant Tippets used the proceeds from the sale of the stock to pay off his house and buy a new car. (Tippets Test., ex. 2 at 63-64.)

III. STANDARD FOR SUMMARY JUDGMENT

Summary judgment should be entered if the record shows that "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). A party moving for summary judgment bears the initial burden of informing the court of the basis of its motion. It may do so by identifying portions of the record that demonstrate that there is no genuine issue of material fact. Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986). In response, the nonmoving party must go beyond the pleadings and by affidavits or other evidence in the record "designate 'specific facts showing that there is a

genuine issue for trial.'" Id. at 324. If the nonmoving party fails to meet this burden, summary judgment is mandated. See id. at 322-24.

IV. DISCUSSION

A. Violation of § 17(a)(1) of the Securities Act and § 10(b) of the Securities Exchange Act

The SEC alleges that Defendants Intelliquis, Orton, and Tippets violated section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, thereunder, 17 C.F.R. § 240.10b-5.

Section 17(a) of the 1933 Act makes it unlawful for a seller of securities, by use of the mails or an instrumentality of interstate commerce, directly or indirectly,

> (1) to employ any device, scheme, or artifice to defraud, or
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> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
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> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C.A. § 77q(a) (Supp. 2003).

Section 10(b) of the 1934 Act applies to both buyers and sellers and makes it unlawful by the use of the mails, an instrumentality of interstate commerce, or a facility of any national securities exchange to employ "any manipulative or deceptive device or contrivance in

contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C.A. § 78j(b) (Supp. 2003).

Rule 10b-5, promulgated under section 10(b), makes it unlawful by the use of an instrumentality of interstate commerce or the mails or any facility of a national securities exchange

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (2003).

In order to establish primary liability under section 10(b) and Rule 10b-5, the SEC must prove that the defendants, in connection with the purchase or sale of securities, acting with scienter, made a material misrepresentation or omission, or used a fraudulent device. SEC v. First Jersey Sec, Inc., 101 F.3d 1450, 1467 (2d Cir. 1996); see Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1031 (2d Cir. 1993); McMahan & Co. v. Wherehouse Entertainment, Inc., 900 F.2d 576, 581 (2d Cir. 1990). "With respect to § 17(a)(1), essentially the same elements must be established in connection with the offer or sale of a security." First Jersey Sec, Inc., 101 F.3d at 1467; see Zerman v. Ball, 735 F.2d 15, 23 (2d Cir. 1984).

The SEC alleges that the undisputed facts prove the following elements:

> (1) Intelliquis, Tippets, and Orton, in connection with the offer, sale and purchase of securities, (2) engaged in a scheme to defraud, made untrue statements and omitted to disclose facts; (3) those misrepresentations or omissions were material, such that a reasonable investor would consider the misrepresented or omitted facts to be important in making an investment decision; (4) Intelliquis, Tippets, and Orton used avenues of interstate commerce in pursuance of these dealings, including telephone and mail contacts; and (5) Intelliquis, Tippets, and Orton acted with the required scienter under Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5, in that they intended to deceive, manipulate or defraud investors or acted recklessly in doing so.

(SEC's Mem. Supp. Summ. J., at 17, dkt. no. 32.)

1. **Scheme to Defraud, Untrue Statements and Omissions**

The SEC contends that Defendants engaged in a fraudulent scheme to artificially inflate the price of Intelliquis stock by causing revenue and accounts receivable to be overstated on the company's books. This was accomplished by improperly recording the transactions with Ingram as sales, when in actuality, they were consignment arrangements, under which Ingram had an unlimited to right to return the product. Further, the revenue amounts were subject to adjustments by Ingram for promotional and other expenses. The inaccurate recording of revenue, which failed to comply with GAAP, was incorporated into Intelliquis' financial statements. The fraudulent financial statements were, in turn, made a part of the reports Intelliquis filed with the SEC.

2. **Materiality of Misrepresentations and Omissions**

A misrepresentation of fact is material if there is a substantial likelihood that a reasonable investor would have viewed it as "having significantly affected the 'total mix' of information made available." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988). In other words, a statement is material "if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether or not to invest his money in a particular security." SEC v. Fife, 311 F.3d 1, 9 (1st Cir. 2002). Summary judgment on the issue of materiality is appropriate where the omissions and misrepresentations are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality." TSC Indus., Inc., 426 U.S. at 450 (quoting Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970)).

In the instant case, the misstatements on Intelliquis' books were so obviously important to investors that reasonable minds could not differ as to their materiality. First, the recording of consignments as sales greatly overstated Intelliquis' revenue. In addition, these "sales" appeared on Intelliquis' books as accounts receivable, even though Ingram had no obligation to pay Intelliquis until the software was sold to third parties. Both these discrepancies would be considered important by a reasonable investor in making an investment decision. This was especially true since sales to Ingram made up such a large percentage of total sales, and accounts receivable constituted more than two-thirds of Intelliquis' total assets.

3. **Jurisdictional Means Requirement**

The jurisdictional requirement is satisfied by the use of the mails or telephone in connection with the fraud. The fraud or misrepresentation itself need not have been communicated through the mails or over the phone so long as the defendant's use of the phone or mails furthers the fraudulent scheme. Harrison v. Equitable Life Assur. Soc. of United States, 435 F. Supp. 281, 284 (W.D. Mich. 1977); Franklin Sav. Bank of N.Y. v. Levy, 551 F.2d 521, 524 (2d Cir. 1977)(stating that "use of the mails need not be central to the fraudulent scheme and may be entirely incidental to it."). See Aquionics Acceptance Corp. v. Kollar, 503 F.2d 1225, 1228 (6th Cir. 1974). The jurisdictional requirement is met in this case since Defendants Tippets and Jones communicated extensively with Ingram by telephone and by mail.

4. **Scienter**

To prove a violation of section 17(a)(1), section10(b), and Rule 10b-5, the SEC must show that Defendants acted with scienter. Aaron v. SEC, 446 U.S. 680, 691, 695, 697, 701-02 (1980). Scienter, with respect to securities fraud, is generally defined as "intent to deceive, manipulate, or defraud," Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983); First Jersey Sec, Inc., 101 F.3d at 1467, or at least "knowing or intentional misconduct." Wechsler v. Steinberg, 733 F.2d 1054, 1058 (2d Cir. 1984); First Jersey Sec, Inc., 101 F.3d at 1467. The Tenth Circuit has expressly held that "recklessness satisfies the scienter requirement." Hackbart v. Holmes, 675 F.2d 1114, 1117 (10th Cir. 1982). The court defined reckless behavior for the purposes of Rule 10b-5 as "an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so

obvious that the actor must have been aware of it." Id. at 1118 (quoting Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977)); accord Fife, 311 F.3d at 9-10. Proof of scienter need not be by direct evidence, but may be inferred from circumstantial evidence. Wechsler, 733 F.2d at 1058; Herman & MacLean, 459 U.S. at 390 n.30.

Defendant Tippets testified in his deposition that he knew that Intelliquis' transactions with Ingram were on a consignment basis. Further, he had lengthy discussions in which Ingram employees explained in detail that Ingram did not owe the amounts that Intelliquis claimed it did. Thus, Defendant Tippets knew that Intelliquis would never receive the amount recorded on its books as revenue. Nevertheless, he allowed that amount to remain on Intelliquis' income statement and balance sheet. The court concludes that this is sufficient to satisfy the scienter requirement.

Defendant Orton either knew, or was reckless in not knowing, that the accounts receivable allegedly due from Ingram were materially overstated on Intelliquis' books. During the course of the audit, the confirmation letter sent to Ingram showed a difference of more that $3 million between Intelliquis' accounts receivable and the amount that Ingram claimed it owed. Defendant Orton made no effort to reconcile this discrepancy, and allowed the accounts receivable to remain on Intelliquis' balance sheet. Thus, the scienter element is met with regard to Defendant Orton.

The court concludes that the SEC has established all of the necessary elements for a violation of section 17(a)(1) of the Securities Act of 1933, section 10(b) of the Securities

Exchange Act of 1934, and Rule 10b-5, thereunder, with regard to Defendants Intelliquis, Tippets, and Orton.

B. Sections 17(a)(2) and (3) of the Securities Act of 1933

In addition to violations of section 17(a)(1) and section 10(b), the SEC has established that Defendants Intelliquis, Tippets, and Orton violated Sections 17(a)(2) and (3) of the Securities Act of 1933 as well. The elements of section 17(a)(2) and (3) are the same as those for Rule 10b-5, except there is no requirement of scienter. Aaron, 446 U.S. at 695-97, 701-02; SEC v. Monarch Funding Corp., 192 F.3d 295, 308 (2d Cir. 1999); First Jersey Sec., Inc., 101 F.3d at 1467. Thus, the conduct described above also constitutes a violation of sections 17(a)(2) and (3).

C. Filing of False Reports with the SEC

Under section13(a) of the Securities Exchange Act, 15 U.S.C. § 78m(a), and Rules 12b-20, 13a-1, and 13a-13, 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13, companies must file registration statements and periodic reports with the Commission. These reports must be accurate and not omit information that would otherwise make the information in the reports not misleading. It is undisputed in the instant case, that Intelliquis filed reports containing false information with the Commission.

Intelliquis filed Forms 10-KSB for the fiscal years ended December 31, 1998 and December 31, 1999. Those documents contained Intelliquis' financial statements in which

Intelliquis had improperly recorded revenue and accounts receivable for its transactions with Ingram. Consequently, Intelliquis' filings with the Commission were false.

In addition to the Forms 10-KSB, Intelliquis included the false financial statements with Forms 10-QSB for the quarters ended March 31, 1999, June 30, 1999, and September 30, 1999. The false financial statements were also included with a Form SB-2 registration statement filed with the Commission. Intelliquis' inclusion of the false financial statements with its filings violated section 13(a) of the Securities Exchange Act and Rules 12b-20, 13a-1, and 13a-13.

D. Failure to Keep Accurate Books and Records

Section 13(b)(2)(A) of the Securities Exchange Act, 15 U.S.C. § 78m(b)(2)A), requires companies filing reports with the Commission to keep books and records that accurately reflect the company's financial condition. In addition, section 13(b)(2)(B), 15 U.S.C. § 78m(b)(2)B), requires such companies to have internal controls sufficient to assure that the company's transactions are properly recorded. It is undisputed that Intelliquis failed to comply with the requirements of sections 13(b)(2)(A) and (B).

E. Aiding and Abetting Liability

The SEC alleges that Defendants Tippets and Orton aided and abetted Intelliquis in filing false reports with the Commission in violation of section 13(a), and that Defendant Tippets aided and abetted Intelliquis in keeping inaccurate books and records in violation of section 13(b)(2).

To establish aiding and abetting liability, the Commission must show (1) a primary violation of the federal securities laws by some other party, (2) knowledge by the aider and abettor of the primary violation; and (3) substantial assistance by the aider and abettor in the primary violation. First Interstate Bank of Denver v. Pring, 969 F.2d 891, 898 (10th Cir. 1992), rev'd on other grounds sub nom. Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994); Farlow v. Peat, Marwick, Mitchell & Co., 956 F.2d 982, 986 (10th Cir. 1992). See also C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1436 (10th Cir. 1988)(upholding aiding and abetting liability where the defendant was aware of the improper scheme and "knowingly participated in it in a substantial way.").

In Pring, the Tenth Circuit held that recklessness satisfies the state-of-mind requirement for aiding and abetting liability in a case based on "assistance by action." Pring, 969 F.2d at 903. Subsequently, the Supreme Court reversed Pring on a ground unrelated to this case, holding that "there is no private aiding and abetting liability under § 10(b)." Central Bank of Denver, 511 U.S. at 191. In response to the Supreme Court's decision in Central Bank of Denver, Congress passed the Private Securities Litigation Reform Act of 1995 which reaffirmed that aiding and abetting liability may be imposed in SEC enforcement actions. The relevant provision provides as follows:

> [A]ny person that knowingly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.

15 U.S.C. § 78t(e)(emphasis added).

The question thus arises whether this section changed the state-of-mind requirement for aiding and abetting liability. The Ninth Circuit has stated that the elements of this section clearly mirror the elements courts traditionally used to define aiding and abetting liability. United States SEC v. Fehn, 97 F.3d 1276, 1288 (9th Cir. 1996). In the court's view, "the symmetry between the elements of aiding and abetting before Central Bank and after Section 104 is a strong indication that Congress intended Section 104 to preserve the definition of aiding and abetting as it existed pre-Central Bank." Id. The court stated that this section "makes clear that the requisite scienter for aiding and abetting is 'knowingly.'" The court observed, however, that this requirement "is in keeping with the traditional scienter for aiding and abetting." Id. at 1295.

In a recent case upholding an SEC disciplinary order against the defendant for aiding and abetting the violation of the record-keeping requirements, the Tenth Circuit indicated that recklessness still is sufficient to satisfy the state-of-mind requirement for aiding and abetting in this circuit. Geman v. SEC, 334 F.3d 1183, 1195, 1196 (10th Cir. 2003). In that case, Geman had been advised by the National Association of Securities Dealers that the firm where he was chairman and CEO, would be required to cease reporting trades in the manner it had been. Thus, he was aware of the cessation of reporting under the old system, and must have known that an alternative reporting method was necessary. However, he took no steps to ensure, or even inquire, whether the firm had made alternative arrangements to satisfy the reporting requirement. The court stated, "Geman's inaction, which was at the very least reckless, amply supports a

finding that he wilfully aided and abetted the Firm's record keeping violations." Id. at 1195 (emphasis added). Finally, the court concluded that there was a "sufficient factual basis for the conclusion that Geman aided and abetted the violations with a state of mind of recklessness, if not willful disregard." Id. at 1196 (emphasis added).

In another recent case, the Ninth Circuit upheld an SEC ruling that the defendant, a CPA who served as a company's independent auditor, had aided and abetted a violation of the accurate reporting and record-keeping provisions of the securities laws. In considering the state-of-mind requirement, the court stated that although the defendant may not have conceived the reports as false or misleading at the time he made them, he "certainly had knowledge, or at least was reckless in not recognizing, the misleading nature of the statements." Ponce v. SEC, 345 F.3d 722, 737 (9th Cir. 2003)(emphasis added).[11] Thus, the Ninth Circuit also seems to recognize that recklessness satisfies the scienter requirement for aiding and abetting violations of the reporting and record-keeping provisions. See also Graham v. SEC, 222 F.3d 994, 1004 (D.C. Cir. 2000)(stating that "knowledge or recklessness is sufficient to satisfy [the scienter] requirement.").

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[11]The Ponce court suggested that there arguably is no scienter requirement for aiding and abetting a violation of section 13(a) and (b). The court observed that "in at least one proceeding the SEC has held that a scienter requirement is not necessary since Section 13(a) violations do not require scienter." Ponce, 345 F.3d at 737 n.10. See In re WSF Corp., 2002 WL 917293, at *3 (SEC, May 8, 2002). The court continued, "Similarly, a plain reading of Section 13(b) reveals that it also does not impose a scienter requirement." Ponce, 345 F.3d at 737 n.10.

As previously discussed, "reckless behavior" is defined as "conduct that is 'an extreme departure from the standards of ordinary care, and which presents a danger . . . that is either known to the defendant or is so obvious that the actor must have been aware of it.'" Pring, 969 F.2d at 903 (quoting Hackbart, 675 F.2d at 1118).

In the instant case, the first element of aiding and abetting, violation of the securities laws by another party, is satisfied, since it is undisputed that Intelliquis filed false and misleading reports with the commission, and failed to keep accurate books and records as discussed above. Further, the undisputed facts show that Defendants Tippets and Orton provided substantial assistance in the primary violations. As discussed above, Tippets was aware that the transactions between Intelliquis and Ingram were not sales. Nevertheless, he continued to permit Intelliquis to record the transactions as sales, which were then carried on the books as inflated accounts receivable, and to file reports with the Commission which contained the false information. Thus, the SEC has shown that Defendant Tippets acted with the requisite scienter.

Defendant Orton also provided substantial assistance in the false reporting by Intelliquis. He was retained to audit Intelliquis' December 1999 financial statements. As discussed, he essentially abandoned all responsibility for this job. He failed to ensure that the assistant he hired was competent to conduct the audit, failed to provide adequate supervision, and did absolutely nothing when Ingram sent correspondence revealing the $3 million discrepancy between what Ingram believed it owed Intelliquis and the amount that Intelliquis reported on its financial statements. Defendant Orton's conduct constituted "an extreme departure from the standards of

ordinary care that carried a known or obvious danger." Pring, 969 F.2d at 904. Orton's inaction allowed Intelliquis to file the false financial statements with the Commission. At the very least, he acted with reckless disregard for his auditing responsibilities. Accordingly, the undisputed evidence establishes that Defendants Tippets and Orton aided and abetted Intelliquis in violation of the reporting and accurate record-keeping requirements.

V. REMEDIES

A. Injunction Against Future Violations of the Securities Laws

The Commission seeks a permanent injunction, pursuant to section 20(b) of the Securities Act and section 21(d)(1) of the Securities Exchange Act, 15 U.S.C. §§ 77t(b), 78u(d)(1), respectively, enjoining Tippets and Orton from future violations of Section 17(a) of the Securities Act, section 10(b) of the Securities Exchange Act, and Rule 10b-5, thereunder. The Commission also seeks to enjoin Intelliquis, Tippets, and Orton from violating the reporting requirements of the federal securities laws. A permanent injunction against future violations of the securities laws may be granted on a motion for summary judgment. SEC v. American Commodity Exch., Inc., 546 F.2d 1361, 1365 (10th Cir. 1976).

Section 20(b) of the Securities Act and section 21(d)(1) of the Securities Exchange Act provide that upon a "proper showing," the SEC may obtain a permanent injunction against any person who is engaged, or about to engage, in a violation of any provision of the securities Acts or regulations. 15 U.S.C. §§ 77t(b), 78u(d)(1). "An injunction based on the violation of

securities laws is appropriate if the SEC demonstrates a reasonable and substantial likelihood that the defendant, if not enjoined, will violate securities laws in the future." SEC v. Pros Int'l, Inc., 994 F.2d 767, 769 (10th Cir. 1993); accord SEC v. Youmans, 729 F.2d 413, 415 (6th Cir. 1984); SEC v. Bonastia, 614 F.2d 908, 912 (3d Cir. 1980). The determination of the likelihood of future violations is made by considering several factors such as (1) the seriousness of the violation, (2) the degree of scienter, (3) whether the defendant's occupation will present opportunities for future violations, and (4) whether the defendant has recognized his wrongful conduct and given sincere assurances against future violations. Pros Int'l, Inc., 994 F.2d at 769; Youmans, 729 F.2d at 415; Bonastia, 614 F.2d at 912; SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978). Although no single factor is determinative, the degree of scienter "bears heavily" on the decision to issue an injunction. Pros Int'l, Inc., 994 F.2d at 769 (quoting SEC v. Haswell, 654 F.2d 698, 699 (10th Cir. 1981)).

Based upon the above factors, an injunction is appropriate against Defendants Tippets and Orton enjoining them from future violations of section 17(a) of the 1933 Act, and section 10(b) of the 1934 Act, and Rule 10b-5, thereunder. Defendant Tippets' past violations were serious in that they resulted in an inflated price for Intelliquis stock from which Mr. Tippets personally profited when he sold his stock at the inflated price. Further, the violations involved a high degree of scienter since Defendant Tippets knew that Intelliquis recorded transactions as sales when they were actually consignment arrangements, but did nothing to correct the misleading practices. In addition, Defendant Tippets was an officer and director of Intelliquis, and

apparently still serves as the president of the company. Thus, his position with the company presents an opportunity for future violations. Finally, he has refused to acknowledge his wrongful conduct. All of these factors weigh in favor of enjoining Defendant Tippets from future violations.

Similarly, Defendant Orton's violations also were serious, and resulted in the filing of false statements with the Commission. Defendant Orton's failure to perform a proper audit also contributed to the maintenance of the inflated stock price since a proper audit most certainly would have revealed that Intelliquis' consignments to Ingram were being improperly booked as sales. Again, the evidence establishes a high degree of scienter. Defendant Orton essentially abandoned his obligations as an independent auditor, failed to supervise his inexperienced associate, and did not examine the business relationship between Intelliquis and Ingram, Intelliquis' most important customer. He ignored Ingram's response to the confirmation letter which revealed over a $3 million discrepancy between the amount Intelliquis claimed that it was owed, and the amount that Ingram's records showed was due to Intelliquis. Further, during the time that Defendant Orton was conducting the Intelliquis audit, he was under investigation for other securities violations for which he was later convicted. Thus, Defendant Orton's conduct was not an isolated occurrence. The court notes that Defendant Orton is presently incarcerated and has given up his CPA license, giving rise to an assumption that he will no longer be conducting independent audits. Although the changed circumstances of a defendant should be considered in deciding whether to issue an injunction, it is well-settled that a change of

occupation alone is insufficient to defeat an injunction. Bonastia, 614 F.2d at 913; Youmans, 729 F.2d at 415. Further, the recurrent nature of the violation weighs heavily in favor of an injunction. Bonastia, 614 F.2d at 913. Finally, Defendant Orton has not acknowledged his wrongdoing, or given assurances against future violations. Accordingly, the court finds that there is a reasonable and substantial likelihood that Defendant Orton will violate the securities laws in the future if not enjoined.

The SEC also seeks an injunction against all three defendants enjoining them from future violations of the reporting requirements. The court finds that such an injunction is appropriate against Defendants Tippets and Orton based upon the factors discussed above. Defendant Intelliquis should also be enjoined from violating the reporting requirements in that its past violations were serious, and it is in a position to commit future violations.

B. Disgorgement of Funds Received from the Sale of Intelliquis Stock

The SEC asserts that Defendant Tippets should be required to disgorge the amounts he received from the sale of Intelliquis stock at artificially inflated prices. It is well settled that the court may order the disgorgement of profits obtained through securities fraud. SEC v. First Pac. Bancorp., 142 F.3d 1186, 1191 (9th Cir. 1998); SEC v. Patel, 61 F.3d 137, 139 (2d Cir. 1995); SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1104 (2d Cir. 1972). The primary purpose of disgorgement is to create a deterrent effect by preventing unjust enrichment of the alleged wrongdoer. First Pac. Bancorp., 142 F.3d at 1191; SEC v. Wang, 944 F.2d 80, 85 (2d Cir. 1991);

SEC v. First City Fin. Corp., 890 F.2d 1215, 1230 (D.C. Cir. 1989); Manor Nursing Ctrs., Inc., 458 F.2d at 1104.

The decision whether to award disgorgement, as well as the amount, is in the broad discretion of the court. First Jersey Securities, Inc., 101 F.3d at 1474-75; SEC v. Lorin, 76 F.3d 458, 462 (2d Cir. 1996). The amount to be disgorged "need only be a reasonable approximation of profits causally connected to the violation." First Jersey Securities, Inc., 101 F.3d at 1475 (quoting Patel, 61 F.3d at 139); First City Fin. Corp., 890 F.2d at 1231.

In the instant case, Defendant Tippets sold 527,250 shares of Intelliquis stock during the time the price of the stock was artificially inflated due to the false financial statements, realizing $188,807.99. After the scheme came to light, the stock price dropped sharply, and the stock became essentially worthless. As a result of his wrongful conduct, Defendant Tippets was unjustly enriched. Therefore, Defendant Tippets is ordered to disgorge the proceeds from the sale of the stock in the amount of $188,807.99.

The SEC also has requested that Defendant Tippets be required to pay prejudgment interest. The decision whether to award prejudgment interest, and at what rate, like the decision to grant disgorgement, is in the broad discretion of the district court. First Jersey Securities, Inc., 101 F.3d at 1476; SEC v. Downe, 969 F. Supp. 149, 158 (S.D.N.Y. 1997). An award of prejudgment interest, like disgorgement, is intended to prevent the violator from profiting from his illegal conduct. SEC v. Sargent, 329 F.3d 34, 40 (1st Cir. 2003). In other words, it prevents

the defendant from receiving "what amounts to an interest free loan procured as a result of illegal activity." SEC v. Moran, 944 F. Supp. 286, 295 (S.D.N.Y. 1996).

In deciding whether to award prejudgment interest, the court considers the following factors: "(i) the need to fully compensate the wronged party for actual damages suffered, (ii) considerations of fairness and the relative equities of the award, (iii) the remedial purpose of the statute involved, and/or (iv) such other general principles as are deemed relevant by the court." First Jersey Securities, Inc., 101 F.3d at 1476; Commercial Union Assurance Co. v. Milken, 17 F.3d 608, 613 (2d Cir. 1994). In an enforcement action brought by the SEC, "the remedial purpose of the statute takes on special importance." First Jersey Securities, Inc., 101 F.3d at 1476.

In the instant case, the SEC has requested an award of prejudgment interest of $24,573.95 against Tippets on the amount of "ill-gotten gains" obtained from the sale of the Intelliquis stock. In support of the requested amount, the SEC has submitted the Declaration of Norman J. Korb, a certified public accountant employed by the SEC. (Ex. 17.) Mr. Korb calculated the amount of prejudgment interest using the published rates assessed on tax underpayments by the Internal Revenue Service. (Korb Decl. ¶ 6.) Several courts have held that the rate charged by the IRS on underpayment of taxes is the appropriate rate to be used in calculating prejudgment interest in similar cases. See, e.g., First Jersey Securities, Inc., 101 F.3d at 1476; SEC v. Parks, 222 F. Supp. 2d 1124, 1132 (C.D. Ill. 2002); SEC v. Kenton Capital, Ltd., 69 F. Supp. 2d 1, 16-17 (D.D.C. 1998); Downe, 969 F. Supp. at 158. The sales of stock by Defendant Tippets took place

from February 23, 2000 through March 14, 2001. (Korb Decl. ¶ 5.) According to Mr. Korb's calculations, the interest accrued from April 1, 2001 to February 28, 2003 is $24,573.95. (Id. ¶ 8.) The court concludes that an award of prejudgment interest against Defendant Tippets in the amount of $24,573.95 would promote fairness and serve the remedial purposes of the antifraud provisions of the securities laws by eliminating financial benefits for violators, thus providing a deterrent effect.

C. Civil Penalties

The SEC has requested that the court impose civil penalties upon Defendants Tippets and Orton pursuant to section 20(d)(2) of the Securities Act and section 21(d) (3) of the Securities Exchange Act, 15 U.S.C. §§ 77t(d)(2), 78u(d)(3). The dual purpose of a civil penalty is to punish the individual violator and to deter future violations of the securities laws. SEC v. Coates, 137 F. Supp. 2d 413, 428 (S.D.N.Y. 2001); Downe, 969 F. Supp. at 159; Moran, 944 F. Supp. at 296. The civil penalty is necessary because disgorgement merely requires the return of illegal profits; it does not impose an actual economic penalty as a deterrent to violations of the securities laws. Kenton Capital, Ltd., 69 F. Supp. 2d at 17; Moran, 944 F. Supp. at 296. The amount of any civil penalty should be determined "'in light of the facts and circumstances' of the particular case." Kenton Capital, Ltd., 69 F. Supp. 2d at 17 (quoting 15 U.S.C. § 78u(d)(3)); SEC v. Berger, 244 F. Supp. 2d 180, 194 (S.D.N.Y. 2001).

The statute establishes three tiers of penalties for a violation of securities laws, with the third tier being the most severe. In the instant case, the SEC argues that a third-tier penalty is appropriate. Third-tier penalties are available when the violation (1) "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," and (2) "resulted in substantial losses or created a significant risk of substantial losses to other persons." 15 U.S.C. §§ 77t(d)(2)(C), 78u(d)(3)(B)(iii); SEC v. Phoenix Telecom, LLC, 231 F. Supp. 2d 1223, 1225 (N.D. Ga. 2001); Kenton Capital, Ltd., 69 F. Supp. 2d at 17. The penalty for a third-tier violation may not exceed $100,000 or the gross amount of the pecuniary gain, whichever is larger. 15 U.S.C. §§ 77t(d)(2)(C), 78u(d)(3)(B)(iii); Phoenix Telecom, LLC, 231 F. Supp. 2d at 1225; Parks, 222 F. Supp. 2d at 1133-34.

In the instant case, the SEC argues that both Defendants Tippets and Orton knowingly and actively engaged in a scheme that artificially inflated the price of Intelliquis stock. After the fraud was revealed, the price plummeted and the stock is now essentially worthless. Thus, Defendants' violations of the antifraud provisions resulted in a complete loss of investor value. Accordingly, both requirements for the imposition of third-tier penalties are satisfied.

The SEC also points out that neither defendant has acknowledged any wrongdoing, and that Defendant Tippets personally profited from the sale of Intelliquis stock. In light of the facts and circumstances of this case, the court finds that the imposition of a third-tier penalty in addition to disgorgement is appropriate against Defendant Tippets. Defendant Tippets' conduct involved fraud and deceit and resulted in a substantial loss, or a significant risk of substantial

loss, to other investors, while he personally benefitted from the scheme. Although a civil penalty is warranted, the court concludes that in light of the other sanctions against Defendant Tippets, the maximum penalty should not be imposed. See Sargent, 329 F.3d at 42 (stating that other penalties that arise out of the defendant's conduct is one factor to be taken into account in imposing civil penalties). Accordingly, the court imposes a civil penalty of $37,762 which represents twenty percent of the profit Defendant Tippets realized from the sale of the stock.

Defendant Orton is presently serving a sentence for an unrelated violation of the securities laws. Although Defendant Orton's conviction tends to show other culpable conduct, the court concludes that it would not further the purpose of the securities laws to impose a civil penalty upon Defendant Orton. See Sargent, 329 F.3d at 42 (stating that the fact of criminal conviction tempers the need for an additional penalty); Patel, 61 F.3d at 142 (noting, in the context of deciding whether to issue an injunction, that the court may take into account any prior punishment that might have been imposed in a criminal proceeding).

D. Injunction Barring Defendant Tippets from Serving as an Officer or Director

The SEC requests that the court grant an injunction barring Defendant Tippets from serving as an officer or director of any public company. The court may prohibit any person who has violated section 10(b) of the Securities Exchange Act from acting as an officer or director of any issuer of securities "if the person's conduct demonstrates unfitness to serve as an officer or director of any such issuer." 15 U.S.C. § 78u(d)(2). Courts have identified several factors to be

considered in making the "unfitness" determination: "(1) the 'egregiousness' of the underlying securities law violation, (2) the defendant's 'repeat offender' status, (3) the defendant's 'role' or position when he engaged in the fraud, (4) the defendant's degree of scienter, (5) the defendant's economic stake in the violation, and (6) the likelihood that misconduct will recur." Patel, 61 F.3d at 141; accord First Pac. Bancorp, 142 F.3d at 1193. Although these factors are useful in making the "unfitness" determination, the court need not apply all of them, and may take other factors into account. Patel, 61 F.3d at 141.

In the instant case, Defendant Tippets was an officer and director of Intelliquis during the time the violations occurred, and still occupies the position of president of the corporation. The underlying violation was egregious, and resulted in risk of substantial loss to other investors. Further, Defendant Tippets acted with a high degree of scienter. He was well aware of the relationship between Intelliquis and Ingram in that he negotiated the agreements between the two companies and interacted with Ingram employees on an almost daily basis. Based on these interactions, Tippets knew that the accounts receivable were not collectible. In short, Defendant Tippets engaged in a scheme to artificially inflate the price of Intelliquis stock. He then sold his stock at the inflated prices, making a profit, while other investors lost money when the scheme was revealed and Intelliquis stock became essentially worthless. Further, Defendant Tippets has not acknowledged any wrongdoing in connection with this scheme. His failure to provide assurance against further misconduct supports a conclusion that additional violations are likely to occur in the future. See SEC v. Posner, 16 F.3d 520, 522 (2d Cir. 1994); First Pac. Bancorp, 142

F.3d at 1193-94. Based on these facts, the court concludes that Defendant Tippets should be permanently barred from acting as an officer or director of any company which files reports with the Securities Exchange Commission.

VI. ORDER

I. IT IS HEREBY ORDERED, ADJUDGED AND DECREED that defendants Intelliquis, Tippets, and Orton, their agents, servants, employees and those persons in active concert or participation with them, who receive actual notice of this Order by personal service or otherwise, and each of them, be and hereby are permanently enjoined from, directly or indirectly, in the offer or sale of any security, by the use of the means or instruments of transportation or communication in interstate commerce or by the use of the mails, employing devices, schemes or artifices to defraud; obtaining money or property by means of untrue statements of material facts or omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or engaging in transactions, practices or courses of business which operate or would operate as a fraud or deceit upon purchasers or prospective purchasers of any security, in violation of Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a).

II. IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendants Intelliquis, Tippets, and Orton, their agents, servants, employees and those persons in active concert or participation with them, who receive actual notice of this Order by personal service or

otherwise, and each of them, be and hereby are permanently enjoined from, directly or indirectly, as principals or aiders and abettors, in connection with the purchase or sale of any security, by the use of the means or instrumentalities of interstate commerce or of the mails, employing devices, schemes or artifices to defraud; making untrue statements of material facts or omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or engaging in acts, practices or courses of business which operate or will operate as a fraud or deceit upon purchasers or sellers or prospective purchasers or sellers of any security, in violation of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder.

III. IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant Intelliquis, and its officers, agents, servants, employees, attorneys, and accountants, and those persons in active concert or participation with any of them, who receive actual notice of this Order by personal service or otherwise, and each of them, be and hereby are permanently enjoined from engaging in transactions, acts, practices and courses of business, and from engaging in conduct of similar purport and object in violation of Section 13(a) and 13(b)(2)(A) and (B) of the Securities Exchange Act, 15 U.S. C. § 78m(a) and (b)(2)(A) and (B), and Rules 12b-20, 13a-1, 13a-13 and 13b2-1, 17 C.F.R. § 240.12b-20, 240.13a-1, 240.13a-13, and 240.13b2-1.

IV. IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant Tippets, and his officers, agents, servants, employees, attorneys, and accountants, and those

persons in active concert or participation with any of them, who receive actual notice of this Order by personal service or otherwise, and each of them, be and hereby are permanently enjoined from aiding and abetting in transactions, acts, practices and courses of business, and from engaging in conduct of similar purport and object in violation of Section 13(a) and 13(b)(2)(A) and (B) of the Securities Exchange Act, 15 U.S. C. § 78m(a) and (b)(2)(A) and (B), and Rules 12b-20, 13a-1, and 13a-13, 17 C.F.R. § 240.12b-20, 240.13a-1, and 240.13a-13.

V. IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant Orton and his officers, agents, servants, employees, attorneys, and accountants, and those persons in active concert or participation with any of them, who receive actual notice of this Order by personal service or otherwise, and each of them, be and hereby are permanently enjoined from aiding and abetting in transactions, acts, practices and courses of business, and from engaging in conduct of similar purport and object in violation of Section 13(a) of the Securities Exchange Act, 15 U.S. C. § 78m(a), and Rules 12b-20, 13a-1, and 13a-13, 17 C.F.R. § 240. 12b-20, 240.13a-1, and 240.13a-13.

VI. IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant Tippets is permanently barred from serving as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Securities Exchange Act, 15 U.S.C. § 78*l*, or that is required to file reports pursuant to Section 15(d) of the Securities Exchange Act 15 U.S.C. § 78*o*(d).

VII. IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant Tippets pay a civil penalty pursuant to Section 20(d)(2) of the Securities Act and Section 21(d)(3) of the Securities Exchange Act of $37,762. Defendant Tippets shall, within 90 days of the entry of this Order and Judgment, pay the full amount of the penalty to the registry of this Court. Such payment shall be (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the United States District Court, District of Utah; and (C) submitted under cover letter that identifies the defendant in this civil action, and the docket number hereof, a copy of which cover letter and money order or check shall be sent to all parties in this action.

VIII. IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant Tippets disgorge the sum of one hundred eighty-eight thousand eight hundred seven dollars and ninety-nine cents ($188,807.99), representing the ill-gotten gains he has received in this matter as described in the Commission's Complaint, plus prejudgment interest in the amount of $24,573.95 for a total of $213,381.94. Defendant Tippets shall, within 90 days of the entry of this Order and Judgment, pay the full amount of disgorgement and prejudgment interest thereon, totaling $213,381.94 to the registry of this Court. Such payment shall be (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the United States District Court, District of Utah; and (C) submitted under cover letter that identifies the defendant in this civil action, and the docket number hereof, a copy of which cover letter and money order or check shall be sent to all parties in this action.

IX. IT IS FURTHER ORDERED, ADJUDGED AND DECREED, that this Court shall retain jurisdiction over this action for the purposes of implementing and carrying out the terms of all orders and decrees which may be entered herein and to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

DATED this 10th day of December 2003.

BY THE COURT:

Paul G. Cassell
United States District Judge

tsh

United States District Court
for the
District of Utah
December 12, 2003

* * CERTIFICATE OF SERVICE OF CLERK * *

Re: 2:02-cv-00674

True and correct copies of the attached were either mailed, faxed or e-mailed by the clerk to the following:

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